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As I see

THE STOCK MARKET AND THE REAL ESTATE READJUSTMENT

SINCE last July the stock market has shown a definite tendency to work lower, at times dropping by amounts which seemed large. Since July the Dow-Jones industrial average has dropped a total of more than 100 points, or 19%. While this undoubtedly is a large loss, it is still relatively slight in comparison with the tremendous drops which the market experienced in the period from 1929 to 1932. Then, in little more than a month, the market dropped by more than 45%. Or, if we were to apply the same figures today, we would expect the market to drop from its present level to about 240 in a month and a half.

The chart on page 465 of this report shows that, great as the recent drops have been, they are not comparable with those of the last big depression.

This chart also shows that the bear market of the 1930's did not occur in one or two drops but in recurring slumps, sometimes interrupted by as many as 5 months of rising values. The total drop from the peak, left the market at the end of 3 years at about 11% of its peak level.

I have not been surprised at the readjustment which has taken place thus far. In fact, I believe that this readjustment will go considerably further. Optimism as represented by stock prices was greater than was justified by fundamental economic conditions, and sooner or later I thought that a large enough number of investors would arrive at this opinion to make the market fall. In my opinion, however, a drop similar to the one which followed 1929 is certainly not probable.

All of the figures which we accumulate on real estate would tend to make me believe that the longest boom we have ever experienced in the United States is definitely ended. If there is any value in studies of the past, it is hard to believe that the readjustment in real estate which has followed every boom will occur quickly. There is considerably more reason for thinking that the readjustment period may be stretched out over a number of years.

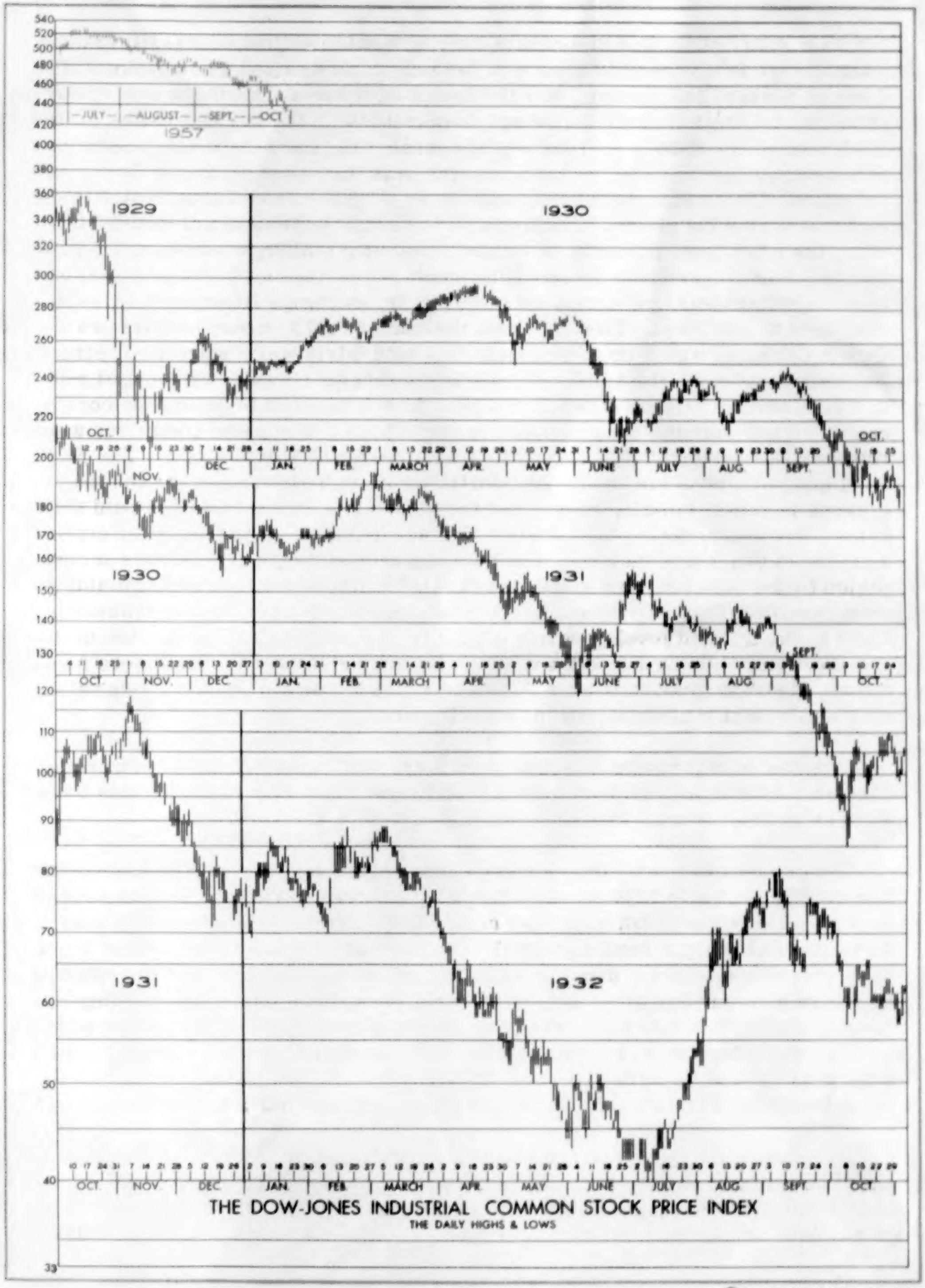
If the real estate boom is over, this will automatically have other implications for the general economy, and this is undoubtedly one of the reasons why the stock market is developing weakness.

I am frequently asked how severe the real estate readjustment is likely to be. I think there is a very good chance of holding it to reasonable proportions. I see no reason, for instance, why the foreclosure rate during the next few years should go to heights similar to those experienced in the big depression of the 1870's or of the 1930's. I realize, of course, that the reason the foreclosure rate went so high in those two readjustments was that those periods followed war inflations. The tremendous foreclosure peak in 1878 was undoubtedly due to the fact that during the greenback inflation, which accompanied and followed the Civil War, the price level rose and the values of existing buildings increased tremendously. Rents increased by about the same percentage as building costs, and since this level was maintained year after year, mortgage financing became accustomed to this level. Then following the panic of 1873, money became scarce. General prices, which up to that time had held fairly well, started to retreat. Building costs fell, the values of existing buildings shrank, residential rents dropped, and foreclosures reached a peak in relationship to population considerably higher than the peak reached in the 1930's. The same conditions were repeated during the 1920's and 1930's as a result of World War I. The price level and building costs rose. Residential rents increased rapidly, and the increases in rents, building costs, and the values of existing buildings held their gains consistently during the 1920's. The war inflation, however, after continuing for 13 years lost its force in 1929, and a drop in the price level was accompanied by a fall in building costs, residential rents, and the values of buildings already built. As a result, mortgage financing, which again had accommodated itself to the inflated level, got into difficulty, as many buildings carried mortgages greater than their deflated values. As some of these properties were foreclosed, distress properties were thrown on a disinterested market, forcing values still lower, which again increased foreclosures.

The real estate readjustment periods of the 1890's and World War I were not serious, and did not result in high foreclosures, as during these periods there were no radical drops in the general price level.

If war inflations were the primary causes of the major readjustments of the late 1870's and early 1930's, why will we not undergo another major catastrophe as a result of a war inflation greater in size and length than the ones which caused these other two major readjustments? For the past 12 years we have been living in an economy where the price level, after rising rapidly, has been maintained on a high plateau year after year. The cost of constructing a new building has gone up during this inflationary period, and with it the values of existing properties. Since the other two big foreclosure peaks followed war inflations not as severe as the one we have just come through, why will we not experience in the period ahead a readjustment greater than the ones of the 1870's and of the 1930's?

It seems to me that there are many factors which are different in the present situation. I believe that the inflated price level has now become so well established that a return to the levels which occurred before 1943 is highly improbable. Although the price level may drop in the next few years, the drops will be


1957
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THE DOW-JONES INDUSTRIAL COMMON STOCK PRICE INDEX
THE DAILY HIGHS & LOWS

relatively minor and will be followed later by increases which will carry the price level even beyond its present height. If the general price level stays close to its present plateau, there is very little chance that the cost of building will come down, and if it does not experience any radical drops, the values of all buildings already standing will not experience great loss.

The one great difference which I see in the present situation in comparison with the situation as it was in 1929 and in 1873 is that in these earlier periods practically all small mortgage loans were made for definite periods, generally from 3 to 5 years in length. During the period of the loan there was seldom any payoff on the principal. When the general economy disintegrated as it did in 1929, loans expiring in 1930, 1931, and 1932, which has been made during the prosperous period, were not renewable, as values in the intervening period had, in many cases, dropped below the amount of the mortgage. Many of these properties, accordingly, went through foreclosure. Contrast that situation with the situation which now exists. Most of the properties which have been sold since 1943 when this boom really got underway have been financed with monthly payoff mortgages. If they were made for very large percentages in the early part of the boom, rising real estate values have reduced the percentage of indebtedness and increased the equity at the same time that the monthly payoff on principal was also increasing the equity. Amortization on many of these mortgages has now continued until they are relatively safe. Even a major drop in real estate values would not bring the value of many of these properties below the mortgage.

Even those mortgages, however, which have been made in the recent past, after real estate values stopped rising, are not in my opinion in great danger of foreclosure. If real estate values should dip by a sufficient amount to destroy any equity, I believe that the persons who made these mortgages would still continue to meet their payments if possible, as these mortgages were made with very favorable financing terms - terms which would not be obtainable in the then current market. In other words, if a home owner has a 20-year mortgage on his home, with a monthly payoff and an interest rate very much more favorable than any terms he could secure now, even though the value of this property dropped, from the standpoint of his monthly housing expenditure he would probably be better off to continue his payments than to default on his obligation and be forced to either rent or buy in a market in which financing costs would be high and relatively unfavorable. Foreclosures would not have gone so high in the 1930's had loans not matured at a time when they could not be refinanced, or if the people owning the houses which dropped in value had been paying a regular monthly amount at a lower interest rate than was current if they were to default and try to rebuy on the lower level.

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